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No._____

The Supreme Court of the United States of America

OCTOBER TERM, 1986

ARKANSAS BEST CORPORATION
AND SUBSIDIARIES,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Did the Court of Appeals for the Eighth Circuit err in holding that losses incurred on sales of corporate stock acquired and held exclusively for business purposes, rather than for investment purposes, did not constitute ordinary business losses under the Internal Revenue Code?

2. Did the Court of Appeals for the Eighth Circuit err in holding that, under Internal Revenue Code §1221, corporate stock not held by a dealer can never qualify as a noncapital asset, regardless of the factual circumstances surrounding its acquisition and retention?

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IN THE

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OPINIONS BELOW

The opinion of the Court of Appeals for the Eighth Circuit below, reversing the judgment of the Tax Court, is reported at 800 F.2d 215 (8th Cir. 1986). The opinion of the Tax Court is reported at 83 T.C. 640 (1984). The opinions of the Court of Appeals and the Tax Court are reproduced in Appendices A and B hereto, respectively.

STATEMENT OF JURISDICTION

The judgment of the United States Court of Appeals for the Eighth Circuit in this case was entered on September 9, 1986. No rehearing has been sought or ordered, and no request for an extension of time within which to file this petition for certiorari has been made. This Court has jurisdiction to review the judgment of the United States Court of Appeals for the Eighth Circuit under 28 U.S.C. §1254(1).

STATUTORY PROVISION INVOLVED

26 U.S.C. (hereafter "I.R.C.") §1221:

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include —

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for the sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;

(3) a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by —

(A) a taxpayer whose personal efforts created such property,

(B) in the case of a letter, memorandum, or similar property, a taxpayer for whom such property was prepared or produced, or

(C) a taxpayer in whose hand the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of a taxpayer described in subparagraph (A) or (B);

(4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1);

(5) a publication of the United States Government (including the Congressional Record) which is received from the United States Government or any agency thereof, other than by purchase at the price at which it is offered for sale to the public, and which is held by —

(A) a taxpayer who so received such publication, or

(B) a taxpayer in whose hands the basis of such publication is determined, for purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such publication in the hands of a taxpayer described in subparagraph (A).[1]

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[1] This statutory language reflects the current version of I.R.C. §1221. This section has been amended three times since this Court's decision in *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, 76 S.Ct. 20, 100 L.Ed. 29 (1955), as follows:

The Tax Reform Act, Pub. L. No. 91-172, §514(a), 83 Stat. 487, 643 (1969), amended I.R.C. §1221(3) to read as above. The amendment was applicable to sales and other dispositions occurring after July 25, 1969. Prior to amendment, I.R.C. §1221(3) read as follows:

(3) a copyright, a literary, musical, or artistic composition, or similar property, held by —

(A) a taxpayer whose personal efforts created such property, or

(B) a taxpayer in whose hands the basis of such property is determined, for the purpose of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of the person whose personal efforts created such property.

The Tax Reform Act of 1976, Pub. L. No. 94-455, §2132(a), 90 Stat. 1520, 1925 (1976), amended I.R.C. §1221 by adding paragraph (6) (what is now paragraph (5)), applicable to sales, exchanges, and contributions made after October 4, 1976. The same Act, at §1901(c)(9), amended I.R.C. §1221(5) by striking out "or Territory," following the word "State", with respect to taxable years beginning after December 31, 1976.

The Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, §505(a), 95 Stat. 172, 331 (1981), repealed former I.R.C. §1221(5) and redesignated I.R.C. §1221(6) as I.R.C. §1221(5), applicable to property acquired or positions established after June 23, 1981, in the years ending after that date. Prior to amendment, former I.R.C. §1221(5) read as follows:

STATEMENT OF THE CASE

Arkansas Best Corporation (hereafter "Arkansas Best") is a diversified holding company based in Fort Smith, Arkansas. In 1968, it owned subsidiaries engaged in trucking, furniture manufacturing, data processing, and other businesses. Because its earnings from these operations were highly cyclical, Arkansas Best decided to acquire businesses which could provide a more stable pattern of earnings over time. One industry which Arkansas Best identified as having this characteristic was the banking or financial services industry.

In pursuit of this business objective, Arkansas Best in 1968 purchased sixty-five percent of the stock of National Bank of Commerce (hereafter the "Bank"), the fourth largest bank in Dallas, Texas. In 1970, however, new Congressional legislation effectively frustrated Arkansas Best's purpose. The Bank Holding Company Act Amendments of 1970, Pub. L. No. 91-607, Title I, §103, 84 Stat. 1760 (1970) (hereafter the "Amendments") prohibited a "one-bank" bank holding company from acquiring new businesses unrelated to banking. Thus, the Amendments would effectively prohibit Arkansas Best — as a "one-bank" bank holding company — from expanding its nonbank businesses, such as trucking or furniture manufacturing, through acquisitions.

The Amendments permitted a company which was unwilling to live with such restrictions to avoid them by committing to divest itself of its interest in its bank. Such a company was required to file with the Board of Governors of the Federal Reserve System an irrevocable notice of intention to divest itself of its bank stock. Arkansas Best filed such a notice on August 1, 1971, and promptly commenced efforts to sell its stock in the Bank.

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(5) an obligation of the United States or any of its possessions, or of a State or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue; or

Public awareness of Arkansas Best's need to sell its Bank stock made it difficult for Arkansas Best to dispose of that stock. Its efforts were made more difficult by increasingly serious financial problems at the Bank. Beginning in 1971, the Office of the Regional Administrator of National Banks made a series of determinations that the Bank's capital was inadequate and demanded that additional capital be raised. Despite the fact that on August 1, 1971 the board of directors of Arkansas Best had passed a resolution stating that the company would purchase additional Bank stock only when absolutely necessary, the deterioration of the financial condition of the Bank forced Arkansas Best to make just such stock purchases to provide the additional capital demanded by the regulatory authorities.

After it filed its notice of intention to divest itself of its Bank stock on August 1, 1971, Arkansas Best made a number of additional purchases of Bank stock ("post-1971 acquisitions"). It did so in an effort to prevent the imposition of sanctions — including a possible closing of the Bank — by the regulatory authorities. Such sanctions would have severely damaged Arkansas Best's reputation as a responsible, competently managed, diversified holding company, as well as its banking and financial relationships.

As to all of these post-1971 acquisitions of Bank stock, Arkansas Best suffered undisputed losses when it finally was able to sell its interest in the Bank beginning in 1975. Arkansas Best sought to deduct these losses from its income as ordinary losses. The Commissioner of Internal Revenue disallowed such deductions, characterizing them as capital losses. Such capital losses are not deductible against the ordinary income of a corporation, but may be used only to offset capital gains.

Arkansas Best challenged the Commissioner's deficiency determination in the United States Tax Court, which had jurisdiction over the action under I.R.C. §6213. After a full trial, the Tax Court made findings of fact regarding Arkansas Best's purposes in making its post-1971 acquisitions of Bank stock. With respect to the stock acquired by Arkansas Best in 1972, the Tax Court found

that such purchases "were motivated primarily by investment purposes and only incidentally by some business purpose." 83 T.C. at 654, Appendix B at B-18. Based upon this Court's decision in *Corn Products Refining Co. v. Commissioner,* 350 U.S. 46, 76 S.Ct. 20, 100 L.Ed. 29 (1955), and its own decision in *W. W. Windle Co. v. Commissioner,* 65 T.C. 694 (1976), *appeal dismissed,* 550 F.2d 43 (1st Cir.), *cert. denied,* 431 U.S. 966 (1977), the Tax Court held that Arkansas Best's losses on the sale of such stock were capital losses. 83 T.C. at 655, Appendix B at B-19.

As to Bank stock acquired after 1972, the Tax Court found that "[t]hese later purchases were made exclusively for business purposes and subsequently held for the same reasons." 83 T.C. at 656, Appendix B at B-20. In particular, the Court held:

> Expenditures to preserve business reputation are typically currently deductible business expenses. (citation omitted). The purchase of stock may be a necessary tactic in the protection of business reputation, and in certain narrow circumstances may invoke the doctrine of *Corn Products.*
>
> . . . .
>
> [Arkansas Best] carried through on a losing proposition solely to preserve its business reputation and therefore we hold that it is entitled to an ordinary loss on the disposition of NBC shares acquired in the years 1973 through 1976.

83 T.C. at 656-57, Appendix B at B-20-21.

Arkansas Best appealed from the Tax Court's finding as to the purpose of the 1972 purchases of Bank stock. Arkansas Best argued that these purchases, like those after 1972, were motivated by business purposes, and not by investment purposes. Among other things, Arkansas Best pointed out the undisputed evidence that it irrevocably had committed itself to sell all of its Bank stock in 1971, and was engaged actively in efforts to accomplish such a divestiture throughout 1972. Its purchases of stock in response to capital calls in 1972 therefore were not part of any effort to invest

in such stock in order to realize a profit, but were made to protect its business reputation and maintain the solvency of the Bank.

The Commissioner, however, appealed from the Tax Court's holding that the losses generated by sales of Bank stock purchased after 1972 were ordinary losses. The Commissioner did not directly challenge the Tax Court's factual findings that the post-1972 stock purchases were made solely for business purposes and with no investment purpose whatsoever. He argued instead that "[t]he findings of fact of the Tax Court demonstrate that the [Bank] stock was never integral to the 'complementary group' of businesses carried on by the taxpayer and its subsidiaries." Brief for the Appellant at 12. The Commissioner contended that the losses resulting from purchases of Bank stock could be treated as ordinary losses only if such stock was "integral" to the business of Arkansas Best.

The Eighth Circuit Court of Appeals on September 9, 1986 held that *all* of the losses resulting from sales of the Bank stock were capital losses. Speaking for a divided court, Judge Bowman held that stock always is a capital asset, regardless of the motives for its acquisition or retention, or any surrounding factual circumstances. The court's opinion expressly rejected holdings of the Courts of Appeals for the Fourth and Fifth Circuits, the Tax Court, and the Court of Claims that had applied this Court's decision in *Corn Products* to stock,[2] and by implication rejected similar holdings of the Courts of Appeals for the Sixth Circuit and Seventh Circuit.[3] In criticizing these decisions, the Eighth Circuit's opinion referred to "*Corn Products* and its progeny,

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[2] *Wright v. Commissioner*, 756 F.2d 1039 (4th Cir. 1985); *Campbell Taggart, Inc. v. United States*, 744 F.2d 442 (5th Cir. 1984); *W. W. Windle Co. v. Commissioner*, 65 T.C. 694 (1976), *appeal dismissed*, 550 F.2d 43 (1st Cir.), *cert., denied*, 431 U.S. 966 (1977); *Booth Newspapers, Inc. v. United States*, 303 F.2d 916 (Ct. Cl. 1962).

[3] *Steadman v. Commissioner*, 424 F.2d 1 (6th Cir.), *cert. denied*, 400 U.S. 869 (1970); *John J. Grier Co. v. United States*, 328 F.2d 163 (7th Cir. 1964).

which we respectfully view as misbegotten." 800 F.2d at 221, Appendix A at A-10.

REASONS FOR ALLOWING THE WRIT

This case involves a rare confluence of several factors which make review of a decision of a court of appeals by this Court necessary. First, the opinion and judgment of the Court of Appeals for the Eighth Circuit in this case is in direct conflict with (and explicitly rejects) the decisions of at least two other courts of appeals, as well as decisions of the Tax Court and the Court of Claims, on the same matter. Second, the Eighth Circuit's opinion and judgment cannot be reconciled with this Court's holding in *Corn Products*, a decision that has been a landmark in United States tax law for over thirty years. Finally, this case squarely presents legal issues which are of fundamental and continuing importance to the proper administration of the tax laws and to the planning of business transactions throughout the nation. Only a definitive decision by the Court in this case can resolve the uncertainty created by the unprecedented ruling of the Eighth Circuit Court of Appeals.

I. THE DECISION OF THE EIGHTH CIRCUIT COURT OF APPEALS DIRECTLY CONFLICTS WITH THE DECISIONS OF OTHER COURTS OF APPEALS, THE TAX COURT, AND THE COURT OF CLAIMS.

The Internal Revenue Code defines as a "capital asset" all property owned by a taxpayer, other than certain enumerated categories of property such as "stock in trade," copyrights, and accounts receivable. I.R.C. §1221. Losses resulting from dispositions of such capital assets generally are available only to offset capital gains and not to offset other income of the taxpayer. In contrast, losses from dispositions of "ordinary" assets generally may be used to reduce ordinary income. I.R.C. §§1211, 1212. On the other hand, certain gains resulting from dispositions of capital assets (long term capital gains) have been taxed at a preferential

rate which is lower than the rate applicable to gains from dispositions of ordinary assets. Therefore, significantly different tax consequences follow from the characterization of a transaction as either capital or ordinary.[4]

In *Corn Products*, the taxpayer had reaped a gain from the purchase and sale of corn futures. The Commissioner opposed the taxpayer's claim that the corn futures were a capital asset and that his profit therefore should be taxed at the preferential capital gains rates. The corn futures — which were used to ensure a supply of corn for the taxpayer's business — clearly did not fall within the literal terms of the exceptions to I.R.C. §1221's definition of "capital asset." The Commissioner nevertheless argued that the futures constituted ordinary assets in view of the specific facts and circumstances of the taxpayer's business.

This Court accepted the Commissioner's argument, holding that I.R.C. § 1221 is not to be read literally. In an opinion for a unanimous Court, Justice Clark wrote:

> Admittedly, petitioner's corn futures do not come within the literal language of the exclusions set out in [the predecessor of §1221] . . . But the capital asset provision of [the predecessor of §1221] must not be so broadly applied as to defeat rather than further the purpose of Congress.

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[4] The Tax Reform Act of 1986, Pub. L. No. 99-514 (1986) (hereafter the "Tax Reform Act of 1986"), signed by the President on October 22, 1986, does not diminish the great importance of this issue to taxpayers and to the Treasury in cases such as these. Although the Act will eliminate — at least for now — the preferential tax rate applicable to long term capital gains, capital losses generally will continue to be deductible only against capital gains. Thus, as under current law, capital losses in excess of capital gains generally will not be deductible against ordinary income, while ordinary losses will be fully deductible against ordinary income. The new tax provisions thus would not have changed the need for resolution of this case or any of the other cited cases from the Courts of Appeals for the Fourth, Fifth, Sixth and Seventh Circuits, the Tax Court or the Court of Claims.

350 U.S. at 51-52, 76 S.Ct. at 24. The Court stated that "since this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly." 350 U.S. at 52, 76 S.Ct. at 24. Thus, the Court held that gains and losses resulting from transactions "vitally important to the taxpayer's business" are not to be taxed as capital transactions. 350 U.S. at 50, 76 S.Ct. at 23.

This Court's holding in *Corn Products* that the particular facts and circumstances of a taxpayer's business in relation to the transaction in question must be considered before the gain or loss with respect to a given asset can be classified as ordinary or capital has been applied by a number of courts in a wide variety of situations over the last thirty years. While certain of these cases, like *Corn Products* itself, involved stock or other intangible assets acquired to guarantee or protect a source of supply,[5] other cases have made it clear that the *Corn Products* doctrine stands for the broader proposition that ordinary gain or loss treatment can apply to a wide range of business-motivated purchases. For example, the *Corn Products* doctrine has been applied where stock or securities were acquired to assure continued business or employment relationships with the issuer of the stock,[6] obtain the use of a valuable asset or the expertise of personnel of the issuing

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[5] *See, e.g., Tulane Hardwood Lumber Co. v. Commissioner*, 24 T.C. 1146 (1955), *acq.*, 1958-1 C.B. 6 (plywood); *Mansfield Journal Company v. Commissioner*, 274 F.2d 284 (6th Cir. 1960) (newsprint); *Booth Newspapers, Inc. v. United States*, 303 F.2d 916 (Ct. Cl. 1962) (newsprint); *F. S. Services, Inc. v. United States*, 413 F.2d 548 (Ct. Cl. 1969) (petroleum products).

[6] *Steadman v. Commissioner*, 424 F.2d 1 (6th Cir.), *cert. denied*, 400 U.S. 869 (1970) (stock acquired to protect taxpayer's position as general counsel); *Southeastern Aviation Underwriters, Inc. v. Commissioner*, 25 T.C.M. (CCH) 412 (1966) (stock acquired to obtain a contract); *Waterman, Largen & Co. v. United States*, 419 F.2d 845 (Ct. Cl. 1969), *cert. denied*, 400 U.S. 869 (1970) (stock acquired to preserve an exclusive sales agency).

corporation,[7] reduce import taxes and assembly costs,[8] and meet contract surety and bonding requirements.[9]

Thus, in applying *Corn Products*, courts have analyzed the reasons for the stock acquisition in the context of the taxpayer's business. Where the stock was acquired and held for business motives, rather than to provide an investment return, the stock has been treated as an ordinary business asset. *Datamation Services v. Commissioner*, 35 T.C.M. (CCH) 1092, 1101 (1976). During the development of this case law over the past thirty years, Congress has amended I.R.C. §1221 three times,[10] without once suggesting that the conclusions of these courts that there can be noncapital assets outside the literal language of I.R.C. §1221 are either "misbegotten" or contrary to Congress' intent.[11]

The Eighth Circuit Court of Appeals plainly was aware of the large body of law interpreting the *Corn Products* decision:

> We acknowledge that in post-*Corn Products* decisions some federal courts have taken the position that capital stock is not a

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[7] *John J. Grier Co. v. United States*, 328 F.2d 163 (7th Cir. 1964) (stock in a corporation acquired to obtain a lease held by the corporation); *Schlumberger Technology Corp. v. United States*, 443 F.2d 1115 (5th Cir. 1971) (stock acquired to obtain the services of a highly skilled team of scientists).

[8] *Pittsburgh Reflector Co. v. Commissioner*, 27 T.C.M. (CCH) 377 (1968).

[9] *Commissioner v. Bagley & Sewall Co.*, 221 F.2d 944 (2d Cir. 1955).

[10] *See* footnote 1, *supra*.

[11] This Court has noted that Congress implicitly validates longstanding and published judicial and administrative interpretations of tax legislation when it reenacts that legislation without substantial change. *See, e.g., Helvering v. Winmill*, 305 U.S. 79, 83, 59 S.Ct. 45, 46, 83 L.Ed. 52 (1938); *Corn Products*, 350 U.S. at 53, 76 S.Ct. at 25 ("Congress has made no change in it [judicial interpretation of tax treatment of hedging transactions] though the Code has been re-enacted on three subsequent occasions. This bespeaks congressional approval.").

capital asset when acquired to assure a supply of raw materials vital to the taxpayer's business, to preserve an existing business, or even to pursue new business. Note, *The Corn Products Doctrine and Its Application to Partnership Interests*, 79 Colum. L. Rev. 341, 343 (1979); Troxell & Noall, *Judicial Erosion of the Concept of Securities as Capital Assets*, 19 Tax L. Rev. 185, 196-207 (1964). A test that some courts apply is the business purpose-investment purpose test: capital stock acquired for business purposes is classified as an ordinary asset, and capital stock acquired for investment purposes is classified as a capital asset. *See Booth Newspapers v. United States*, 303 F.2d 916, 921 (Ct. Cl. 1962); *Dearborn Co. v. United States*, 444 F.2d 1145, 1166 (Ct. Cl. 1971). Other courts have rejected this test, at least for situations in which the taxpayer had mixed motives for acquiring the asset, and have replaced it with a substantial investment purpose test. Note, *supra*, at 347. *See, e.g., W. W. Windle Co. v. Commissioner*, 65 T.C. 694, 703-04 (1976), *appeal dismissed*, 550 F.2d 43 (1st Cir. 1977), *cert. denied*, 431 U.S. 966 (1977); *Wright v. Commissioner*, 756 F.2d 1039, 1041-42 (4th Cir. 1985). Under this test, property is treated as an ordinary asset only if the taxpayer bought and retained it without a substantial investment purpose. Note, *supra*, at 347; *see W. W. Windle*, 65 T.C. at 712, 713, 714 n.15.

800 F.2d at 220, Appendix A at A-8-9. However, the Eighth Circuit then directly and explicitly repudiated all of these cases: "With all due respect to these courts, it is clear to us that both tests lack a basis in the statutory language, and we reject them." 800 F.2d at 220, Appendix A at A-9.

Thus, the decision of the Court of Appeals in this case avowedly conflicts with decisions of the Fourth Circuit Court of Appeals, the Tax Court, and the Court of Claims. In addition, the ruling of the Eighth Circuit necessarily conflicts with other decisions of those courts and of the Second, Fifth, Sixth, and Seventh Circuit Courts of Appeals as cited in notes 5-9, *supra*, all holding that corporate stock or securities could and did constitute an ordinary asset under the facts and circumstances presented in those cases.

Even these cited cases do not exhaust the long list of conflicts between the Eighth Circuit's decision and the decisions of other courts which have applied the *Corn Products* doctrine. Almost simultaneously with the Tax Court's ruling in this case, the Court of Appeals for the Fifth Circuit issued its decision in *Campbell Taggart, Inc. v. United States,* 744 F.2d 442 (5th Cir. 1984).[12] In *Campbell Taggart,* the Fifth Circuit held that a holding company's loss on the disposition of shares of stock gave rise to an ordinary loss in circumstances very similar to those present in the *Arkansas Best* case. The Eighth Circuit acknowledged *Campbell Taggart* as "the case most closely analogous to the one before us," but then stated "[f]or the reasons delineated above, we do not agree with the Fifth Circuit's interpretation of Section 1221." 800 F.2d at 221, Appendix A at A-10.

A brief examination of *Campbell Taggart* makes apparent the parallels with this case. Campbell Taggart, a holding company owning businesses in the food industry, entered into an agreement to purchase fifty percent of the stock of a Spanish corporation that operated a chain of supermarkets. The agreement gave Campbell Taggart the right to terminate the contract if there was any material adverse change in the financial status of the Spanish corporation before the transaction was closed. 744 F.2d at 444-46.

Just such a change occurred, and Campbell Taggart was no longer legally obligated to carry through with the purchase of the stock. However, after considering the negative impact of a failure to acquire the stock on its business reputation, Campbell Taggart — like Arkansas Best in this case — decided to go ahead with the purchase. Also like Arkansas Best, Campbell Taggart began to look for a buyer for the stock immediately — even before the stock purchase was closed. When Campbell Taggart sold the stock at a loss of over one million dollars, it sought to deduct that amount as an ordinary loss.

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[12] The Fifth Circuit's decision was issued only ten days before that of the Tax Court, and it appears that the Tax Court was not aware of *Campbell Taggart* when it decided this case.

The District Court found that, at the time the stock was actually acquired, Campbell Taggart had no investment motive — only a motive to protect its business reputation. *Campbell Taggart, Inc. v. United States,* 552 F.Supp. 355, 357-59 (N.D. Tex. 1982). The Fifth Circuit affirmed, stating that the test under *Corn Products* is simply "whether the asset was acquired with a business purpose or an investment purpose." 744 F.2d at 457-58. The nature of the factual inquiry necessary under *Corn Products* was carefully explained by the Fifth Circuit:

> The inquiry into taxpayer's purpose requires an objective evaluation of all of the circumstances surrounding the transaction. Relevant factors include (1) taxpayer's statements of its subjective intent at the time of acquisition; (2) taxpayer's statements of its subjective intent at the time of disposition; (3) the needs of the particular business; (4) the length of time the asset was held; (5) the nature of taxpayer's other business and investment activities; and (6) the business and investment advantages that might reasonably be expected to flow from the acquisition or expenditure.

Campbell Taggart, Inc., 744 F.2d at 458 (footnotes omitted).

Under the Eighth Circuit's holding in this case, such an inquiry is not only unnecessary but wholly irrelevant. If the asset is "stock," its sale will result in a capital gain or loss regardless of any facts the taxpayer can possibly present. Thus, the Eighth Circuit's holding has introduced a new, and wildly disparate, interpretation of *Corn Products* to the body of jurisprudence that has evolved over the last thirty years. Only review by this Court can definitively resolve the direct conflict among the courts of appeals, the Tax Court, and the Claims Court which plainly exists in this case. This alone is ample reason for the granting of this petition for writ of certiorari. *See* Rule 17.1(a), Rules of United States Supreme Court.

II. THE DECISION OF THE EIGHTH CIRCUIT COURT OF APPEALS CANNOT BE RECONCILED WITH THIS COURT'S DECISION IN *CORN PRODUCTS*

In its opinion in this case, the Eighth Circuit Court of Appeals emphasized its conclusion that the wording of I.R.C. §1221 requires that the Bank stock be regarded as a capital asset under any and all circumstances. It seemed to view this Court's *Corn Products* decision as an aberration from the proper, "literal" application of the statute. The court stated that "[a]lthough a literal reading of section 1221 clearly requires capital stock to be treated as a capital asset, the decision of the Supreme Court in [*Corn Products*] placed a judicial gloss on the section." 800 F.2d at 219, Appendix A at A-6.

After describing the *Corn Products* decision, the Eighth Circuit then suggested that the continuing vitality of that case was questionable. In its reference to this Court's decision in *United States v. Mississippi Chemical Corporation*, 405 U.S. 298, 92 S.Ct. 908, 31 L.Ed.2d 217 (1972), the opinion stated: "In *Mississippi Chemical*, the Supreme Court based its characterization of capital stock as a capital asset solely on the language of section 1221, and ignored its previous decision in *Corn Products* entirely." 800 F.2d at 219-20, Appendix A at A-8.[13] The Eighth

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[13] This Court did not discuss *Corn Products* in deciding *Mississippi Chemical* because *Corn Products* was irrelevant to the issue before the Court in that case. As the Government recognized in its brief in *Mississippi Chemical*:

> Respondents are not helped by cases purporting to apply the rationale of [*Corn Products*] ..... [T]he issue in [the *Corn Products*-related] cases is whether the stock sold was a *capital* asset within the meaning of Section 1221. (It was assumed in each case that the stock was an asset.) Here, on the other hand, there has been no sale, and the issue is whether the stock purchased is an asset, not whether it is a capital asset.

See Brief for United States at 37 n.33, *United States v. Mississippi Chemical Corporation*, 405 U.S. 298, 92 S.Ct. 908, 31 L.Ed.2d 217

Circuit based its decision in this case on principles unmistakably inconsistent with the holding of this Court in *Corn Products*:

> *Corn Products* and its progeny, which we respectfully view as misbegotten, have [led] to increased recourse to the administrative and judicial processes to resolve conflicting contentions about taxpayers' motivations in purchasing capital stock. . . . We believe that the judiciary lacks authority to create exceptions to section 1221 that Congress did not choose to make.

800 F.2d at 221, Appendix A at A-10.

The inconsistency of the Eighth Circuit's opinion in this case with this Court's decision in *Corn Products* is made clear by this example. Suppose that Corn Products Refining Company, instead of purchasing corn futures to ensure its supply of corn, had chosen to purchase all of the stock of a grain dealer for the same purpose. In years in which the Refining Company needed no additional supply, the grain dealer would sell its grain to customers on the open market. In other years, however, the grain dealer could supply the business needs of the Refining Company for corn at a reasonable price — precisely the function performed by corn futures.

Under the Eighth Circuit's decision in this case, a gain or loss on the sale of such stock plainly would be a capital gain or loss. "Stock" is a capital asset under that decision regardless of any other circumstances. Under the rationale of *Corn Products*, however, any gain or loss on such stock can only be an ordinary gain or loss. Thus, despite the Eighth Circuit's silence on this precise point, it is unavoidable that the Eighth Circuit's decision in this

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(1972) (No. 71-52). The Eighth Circuit apparently believed that *Mississippi Chemical* overruled *Corn Products sub silentio*. The Eighth Circuit misread *Mississippi Chemical* by confusing the issue of *when* gains and losses are *recognized* with the issue of the *characterization* of those gains and losses, once recognized, as capital or ordinary.

case and *Corn Products* are in conflict. The decisions in the two cases simply cannot be reconciled, and only this Court can determine which one correctly states the law on this important issue.

Arkansas Best believes that *Corn Products* was correctly decided, and that the rigid approach to statutory interpretation followed by the Eighth Circuit is inappropriate. A willingness to interpret the tax law so as to carry out the *purposes* of Congress, rather than the letter of the statute only, has been a central feature of this Court's decisions both before and after *Corn Products*. *See Pinellas Ice & Cold Storage Co. v. Commissioner*, 287 U.S. 462, 53 S.Ct. 257, 77 L.Ed. 428 (1933) (imposition of nonstatutory requirement of "continuity of proprietary interest" to qualify as a tax-free reorganization); *Helvering v. Morgan's Inc.*, 293 U.S. 121, 126, 55 S. Ct. 60, 61, 79 L.Ed. 232 (1934) ("The true meaning of a single section of a statute in a setting as complex as that of the revenue acts, however precise its language, cannot be ascertained if it be considered apart from related sections, or if the mind be isolated from the history of the income tax legislation of which it is an integral part."); *Gregory v. Helvering*, 293 U.S. 465, 55 S.Ct. 266, 79 L.Ed. 596 (1935) (literal compliance with statute does not give rise to tax-free reorganization in absence of business purpose); *Hillsboro National Bank v. Commissioner*, 460 U.S. 370, 103 S.Ct. 1134, 75 L.Ed.2d 130 (1983) (corporation must recognize income under tax benefit rule despite express non-recognition treatment provided by I.R.C. § 336(a)); *Commissioner v. Tufts*, 461 U.S. 300, 103 S.Ct. 1826, 75 L.Ed.2d 863 (1983) (amount realized upon disposition equals the full amount of a nonrecourse mortgage in excess of the property's fair market value even though not within the meaning of "amount realized" as defined in I.R.C. § 1001(b)); *Bob Jones University v. United States*, 461 U.S. 574, 103 S.Ct. 2017, 76 L.Ed.2d 157 (1983) (a qualifying "educational" organization under I.R.C. § 501(c)(3) must additionally be charitable in the common law sense in order to qualify for tax exempt status). As stated by Judge Hanson in dissenting from the Eighth Circuit's opinion in this case:

> The majority opinion scorns *Corn Products* and its progeny as fostering uncertainty in taxpayer's motivations in purchasing capital stock, favoring instead a return to the literal meaning of section 1221. . . .
>
> It appears to me, however, that *Corn Products* was merely an attempt to divine Congressional intent.

800 F.2d at 221, Appendix A at A-11. Arkansas Best therefore believes — like every court other than the Eighth Circuit which has considered these issues — that *Corn Products* is neither moribund nor a case to be effectively overruled *sub silentio*.

The attempt by the Eighth Circuit to support its unprecedented decision in this case on the ground that it establishes a bright-line rule which does not require administrative or judicial determination of a taxpayer's motivations also ignores the countless other areas of the tax law which expressly require just such a determination. I.R.C. §1221(1) itself defines as a noncapital asset property "held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." This determination by necessity involves considering the taxpayer's motives for holding an asset — for sale to customers or as an investment. While avoiding the need for administrative and judicial proceedings to determine a taxpayer's subjective intentions may be an overriding goal of the Eighth Circuit, it is apparent that Congress in enacting I.R.C. §1221 did not assign such a high priority to that goal.

If Arkansas Best is correct in this respect, the Eighth Circuit's decision in this case clearly should be reversed by this Court. It is the duty of a court of appeals in our judicial system to apply the law as set forth in this Court's decisions, regardless of the views of the court of appeals as to the correctness or wisdom of such decisions. *See, e.g., Hutto v. Davis*, 454 U.S. 370, 374-75, 102 S.Ct. 703, 706, 70 L.Ed.2d 556 (1982); *Jaffree v. Wallace*, 705 F.2d 1526, 1532-33 (5th Cir. 1983); *United States v. Caldwell*, 543 F.2d 1333, 1370 (D.C. Cir. 1975), *cert. denied*, 423 U.S. 1087 (1976). The precedents established by this Court must be followed unless and until they are overruled. *See, eg., Thurston Motor Lines, Inc. v. Jordan K. Rand, Ltd.*, 460 U.S. 533, 535, 103

S.Ct. 1343, 1344, 75 L.Ed.2d 260(1983). Because *Corn Products* simply cannot be reconciled with the Eighth Circuit's assertion that "the judiciary lacks authority to create exceptions" to the literal language of I.R.C. §1221, Arkansas Best believes that certiorari should be granted to resolve that conflict and ensure that this Court's decisions are faithfully applied. *See* Rule 17.1(c), Rules of United States Supreme Court; *see also Vermont Yankee Nuclear Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519, 525, 98 S.Ct 1197, 1202, 55 L.Ed.2d 460 (1978).

Even if Arkansas Best were wrong in this, however, certiorari would still be called for here. If *Corn Products* is to be effectively overruled, it is this Court and this Court alone which has the authority to take that action. Accordingly, certiorari is essential to the proper functioning of our federal judicial system under the circumstances of this case, regardless of its ultimate outcome.

III. REVIEW OF THE DECISION OF THE EIGHTH CIRCUIT COURT OF APPEALS IS NEEDED TO PROMOTE UNIFORM ADMINISTRATION OF THE TAX LAWS AND PROPER PLANNING FOR BUSINESS TRANSACTIONS.

Prior to the Eighth Circuit's decision in this case, the courts uniformly had held that corporate stock transactions could, in certain circumstances, give rise to ordinary gains or losses. Tax advisers and planners throughout the nation were aware of the "business purpose — investment purpose" dichotomy set forth in the Court of Claims' decision in *Booth Newspapers*, and the "mixed motive" holding of the Tax Court in *W.W. Windle*. Their advice was based on those decisions and other similar ones, and taxpayers have acted on that advice.

With the decision of the court of appeals in this case, the predictability of the tax consequences of stock transactions in various states has been diminished greatly. A taxpayer who anticipates purchasing stock for what he and his advisers believe clearly are business purposes, rather than investment purposes,

may have a very difficult time assessing the possible tax results. If a loss ensues and the taxpayer is in a circuit which has not yet ruled on the issues presented in this case, who is to know whether the loss will be treated as ordinary or capital?

Just as undesirable as the lack of predictability of tax results are the inequities in the administration of the tax laws which would result if the Eighth Circuit's decision were not reviewed by this Court. The same business transaction should not generate vastly different federal tax consequences depending upon whether the taxpayer is based in Arkansas or across the state line in Texas or Louisiana.[14] The tax consequences to the Arkansas taxpayer also should not vary greatly based upon its decision to challenge an assessment of tax by the Commissioner in the Tax Court and Eighth Circuit rather than to seek a refund of the tax paid in the Claims Court under *Booth Newspapers*.

These uncertainties and conflicts among the circuits must be resolved, because they will not simply fade away. The distinction between capital gains and losses and ordinary gains and losses which is at the heart of I.R.C. §1221 will continue to have great significance even under the changes in the tax law to be made by the Tax Reform Act of 1986. These changes will cause long term capital gains and ordinary income to be taxed at the same rates beginning in 1988.[15] However, only ordinary losses (and not capital losses) will be available to offset ordinary income. For example, a taxpayer with capital losses and ordinary income, but

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[14] For example, if the Bank stock at issue in this case had been purchased by a Texas company which was in all other respects identical to Arkansas Best, the Fifth Circuit's decision in *Campbell Taggart* would have compelled a far different result than that reached by the Eighth Circuit.

[15] The Conference Report explicitly states that the provisions relating to capital gains, including the definition of capital asset, are to remain in the Internal Revenue Code in contemplation of a possible restoration of a preferential tax rate for capital gains in the future. H.R. Rep. No. 841, 99th Cong., 2nd Sess. 106 (1986).

no capital gains, will not be able to utilize the capital losses to offset his ordinary income, despite the fact that the ordinary income will be subject to the same maximum rate of tax as capital gains. Similarly, if a taxpayer like that in *Corn Products* realizes a gain on corn futures, its capital losses will not offset that gain. Thus, the capital/ordinary asset distinction will continue to play a vital role under the new tax law, and a clear resolution of the issues presented in this case will be critical both to taxpayers and to the proper administration of the tax laws. *See, e.g., Donaldson v. United States*, 400 U.S. 517, 522, 91 S. Ct. 534, 538, 27 L.Ed.2d 580 (1971).

CONCLUSION

For all of these reasons, certiorari should be granted in this case. The decision of the Eighth Circuit does not merely modify the settled law under *Corn Products*; it effectively repudiates that law and the many decisions of the courts of appeals, the Tax Court, and the Court of Claims interpreting *Corn Products*. The continuing existence of such a decision by the Court of Appeals for the Eighth Circuit in an area of such economic importance cannot fail to have serious adverse results, and a clarification of the law by this Court is the only remedy.

Respectfully submitted,

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APPENDIX

APPENDIX A

United States Court of Appeals
For The Eighth Circuit
800 F.2d 215
No. 85-1702
No. 85-1818

APPENDIX B

United States Tax Court
83 T.C. No. 35
Docket No. 18954-80

APPENDIX A

United States Court of Appeals

FOR THE EIGHTH CIRCUIT

No. 85-1702

ARKANSAS BEST CORPORATION AND SUBSIDIARIES,
Appellee,
v.
COMMISSIONER OF INTERNAL REVENUE,
Appellant.

Appeal from the United States Tax Court

No. 85-1818

ARKANSAS BEST CORPORATION AND SUBSIDIARIES,
Appellant,
v.
COMMISSIONER OF INTERNAL REVENUE,
Appellee.

Appeal from the United States Tax Court

Submitted: February 13, 1986
Filed: September 9, 1986

Before HEANEY and BOWMAN, Circuit Judges, and HANSON,* Senior District Judge.

* The HONORABLE WILLIAM C. HANSON, Senior District Judge for the Southern District of Iowa, sitting by designation.

BOWMAN, Circuit Judge.

The issue in this case is whether a corporate taxpayer is entitled to ordinary loss treatment for losses incurred on transactions in the capital stock of another corporation. Both Arkansas Best Corporation (Arkansas Best) and the Commissioner of Internal Revenue (Commissioner) appeal the Tax Court's judgment upholding in part and disallowing in part the Commissioner's treatment of Arkansas Best's losses on such transactions as capital losses. *Arkansas Best Corp. & Subsidiaries v. Commissioner*, 83 T.C. 640 (1984). Arkansas Best also appeals the court's ruling upholding the Commissioner's disallowance of a claimed bad debt deduction. *Id.* at 660-62. We reverse insofar as the Tax Court allowed ordinary loss treatment for any of the capital stock transactions. In all other respects, we affirm.

I.

Arkansas Best is a diversified holding company. Its subsidiaries are engaged in various endeavors including interstate trucking, new tire sales, used tire retreading, and data processing. In 1968, Arkansas Best acquired approximately 65% of the stock of the National Bank of Commerce (Bank). In 1970, Congress amended the Bank Holding Company Act, Pub. L. No. 91-607, Title 1, § 103, 84 Stat. 1763 (codified at 12 U.S.C. § 1841 *et seq.*), to prohibit bank holding companies such as Arkansas Best from acquiring nonbanking businesses. Thereafter, in August 1971, Arkansas Best filed a notice of divestiture and began trying to sell its Bank stock. Once the notice was filed, Arkansas Best, although still a bank holding company, was free to acquire nonbanking businesses.

Because the Bank had made a series of bad loans, selling the Bank stock proved difficult. While actively trying to sell its interest in the Bank, Arkansas Best participated in preemptive rights offerings and capital calls to improve the Bank's capital structure. In 1972, Arkansas Best also bought the Bank president's personal holdings of Bank stock to secure his resignation

and noninterference in the sale of Arkansas Best's interest in the Bank shares. In addition, in 1974 Arkansas Best bought the Bank stock held by one of its subsidiaries, an insurance company.

In 1975, Arkansas Best finally was able to sell over half of its holdings of Bank stock to a group of Texas investors. It received cash and a nonrecourse note secured by the stock. Shortly thereafter, Arkansas Best's independent auditors recommended that it charge off its books $4,485,876 of the face amount of the note, although the note was not in default, reducing its basis to $1,520,300. Three months later, Arkansas Best sold the note for $1,652,500. It also granted a third party an option to purchase its remaining shares of Bank stock in installments; by the end of 1980, Arkansas Best no longer held any shares of Bank stock. On its 1975 income tax return, Arkansas Best claimed an ordinary loss deduction of $9,995,688 from the disposition of the Bank stock, and on its 1976 income tax return, it claimed a deduction for an ordinary loss of $4,353,656 from the sale of the note. The Commissioner disallowed both deductions, deciding that the losses resulting from the sales of stock were capital losses subject to 26 U.S.C. § 1221. Arkansas Best challenged those disallowances in a petition to the Tax Court. As an alternative in its petition, Arkansas Best claimed it was entitled to a deduction on its 1975 income tax return of $4,485,876 for the partial worthlessness of the note. Before the Tax Court, Arkansas Best dropped the 1976 claim deduction and asserted only the claim for a 1975 deduction for the partial worthlessness (bad debt) of the note.

The Tax Court held that the loss realized on stock acquired from 1968 through 1972 was a capital loss because the Bank was not an integral and necessary part of Arkansas Best's business. The shares were an investment. 83 T.C. at 655. However, the court also held that the purchase of stock from the Bank president in 1972 was motivated by business purposes and that the loss upon sale of that stock was entitled to ordinary loss treatment. *Id.* at 657. Similarly, the court found that Arkansas Best's purchases of Bank stock after 1972 were made to protect its business reputation, and therefore that it was entitled to ordinary loss

treatment for losses realized on the disposition of Bank stock acquired after 1972, except in the case of Bank stock that Arkansas Best acquired from a subsidiary in 1974. *Id.* The court further held that the Commissioner had not abused his discretion in denying the deduction for the partial worthlessness of the note as claimed in Arkansas Best's 1975 income tax return. *Id.* at 661.

On appeal, Arkansas Best challenges three aspects of the Tax Court's decision: (1) that its losses realized on stock acquired in preemptive rights offerings were not entitled to ordinary loss treatment; (2) that it is not entitled to ordinary loss treatment on its losses from the Bank stock purchased from its subsidiary; and (3) that it is not entitled to a bad debt deduction for the 1975 tax year for the losses attributable to the nonrecourse note. The Commissioner appeals the Tax Court's decision that Arkansas Best is entitled to ordinary loss treatment for losses incurred on stock acquired after 1972 and for losses incurred on stock acquired from the Bank president.

II.

Arkansas Best argues that all the purchases of Bank stock it made after declaring it would divest itself of the stock were made in the ordinary course of business. Distinguishing its concededly pre-August 1971 investment motives for buying the Bank stock, Arkansas Best asserts that its subsequent purchases were intended to preserve its business reputation by preventing the Bank from failing, and that losses incurred on the sale of the stock so acquired are ordinary business expenses that it can deduct in full from gross income.

Whether these arguments have merit depends upon whether any of the Bank stock that Arkansas Best acquired can be characterized as not being a "capital asset" within the meaning of 26 U.S.C. § 1221. This section establishes a general rule defining capital asset as "property held by the taxpayer (whether or not connected with his trade or business) . . . ." The corresponding federal regulation, 26 C.F.R. § 1.1221-1(a), states that "[t]he

term 'capital assets' includes all classes of property not specifically excluded by section 1221." The property that section 1221 excludes from the general rule is (1) stock in trade or inventory; (2) business property subject to the depreciation allowance or real property used in business; (3) copyrights, literary or artistic compositions, and similar property; (4) business-related accounts or notes receivable; and (5) federal government publications. Because capital stock plainly does not fall into any of the last four categories, we consider only the first exception, 26 U.S.C. § 1221(1), which excludes from "capital asset"

> stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business . . . .

Generally, capital stock would meet this exception only if the taxpayer's business consisted of dealing in securities. *See Campbell Taggart, Inc. v. United States,* 744 F.2d 442, 449 (5th Cir. 1984); 3A J. Rabkin & M. Johnson, *Federal Income, Gift and Estate Taxation* § 34.01A(1), at 3405a (1986).[1] Arkansas Best is not a dealer in securities. It is a holding company which provides management services to its subsidiaries in exchange for fees. Arkansas Best also realizes income from the dividends it receives on the stock it holds. Arkansas Best did not hold its Bank stock and it never has held its stock in any of its subsidiaries for sale to "customers." Rather, it holds capital stock to secure a controlling interest in each subsidiary and to derive income therefrom.

We conclude that the Bank stock was a capital asset because it does not fall into one of the statutory exceptions. The underlying purpose of section 1221 and its legislative history reinforce our

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[1] If Arkansas Best were characterized as dealing in securities, it would be subject to the capital gains and ordinary loss provisions of 26 U.S.C. § 1236, which singles out security dealers for special treatment, rather than to section 1221.

conclusion. According to H.R. Rep. 704, 73d Cong. 2d Sess. (1934), the purpose of the tax code amendments, part of which defined "capital asset," was to increase revenue by preventing tax avoidance. *Id.* at 1. Elsewhere, the report specifically refers to the definition of capital asset: "It will be noted that the definition includes all property, except as specifically excluded." *Id.* at 31. This language is virtually identical to that of Federal Regulation 1.1221-1(a). *See generally* Troxell & Noall, *Judicial Erosion of the Concept of Securities as Capital Assets,* 19 Tax L. Rev. 185, 186 (1964).

Although a literal reading of section 1221 clearly requires capital stock to be treated as a capital asset, the decision of the Supreme Court in *Corn Products Refining Co. v. Commissioner,* 350 U.S. 46 (1955), placed a judicial gloss on the section. In that case, the Court considered the taxpayer's contention that income from trading in corn futures was entitled to capital gains treatment. The Court found that the purchases of corn futures by the taxpayer, which was a manufacturer of products derived from corn, were important to its business because they assured a source of raw material for less than the cost of building additional storage facilities. The Court likened the corn futures contracts to a stored inventory of raw corn, 350 U.S. at 50, and held that under section 117 (identical for our purposes to section 1221) the taxpayer was not entitled to treat the profit made on the corn futures transactions as capital gains; rather, those profits were ordinary income. *See id.* at 51-52.

The Supreme Court recognized in *Corn Products* that the taxpayer's transactions did not fall within the literal language of the exclusions in section 117. The Court reasoned, however, that

> Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than [as] capital gain or loss. The preferential treatment provided by § 117 applies to transactions in property which are not the normal source of business income. . . . Since this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition

> of a capital asset must be narrowly applied and its exclusions interpreted broadly.

Id. (citations omitted).

Our Court has declined all previous invitations to extend *Corn Products* beyond its facts. In *Municipal Bond Corp. v. Commissioner,* 382 F.2d 184 (8th Cir. 1967), our Court adhered to the view expressed by the Supreme Court in *Malat v. Riddell,* 383 U.S. 569, 572 (1966), that the purpose of section 1221 is to differentiate between (1) the profit and loss attributable to daily business operations and (2) the change in value of an asset accruing over a substantial time period. Our Court held that there was no substantial evidence to support the Tax Court's finding that the taxpayer's real estate had been acquired primarily for sale in the ordinary course of business. Therefore, we held that the proceeds of the sale of the property were entitled to capital gains treatment. *Municipal Bond,* 382 F.2d at 187. *See Vaaler v. United States,* 454 F.2d 1120, 1122-23 (8th Cir. 1972) (contract for performance of personal services is not a capital asset and lump sum paid to extinguish the right to render such services is ordinary income); *Frank v. Commissioner,* 321 F.2d 143, 148-49 (8th Cir. 1963) (taxpayers were engaged in the business of selling stock; thus the gains realized from stock transactions were not entitled to capital asset treatment). In *Stephens, Inc. v. United States,* 464 F.2d 53, 57-58 (8th Cir. 1972), *cert. denied,* 409 U.S. 1118 (1973), this Court held that " 'investor' status attaches to anyone, including a recognized 'dealer,' who acquires securities with the primary intent to profit from their income yield." The Court concluded that the investment company was not a "dealer" entitled to an ordinary loss deduction for shares of corporate stock purchased with a view to gaining an economic advantage through receipt of dividends and an increase in the market price of the shares.

In *M.F.A. Central Cooperative v. Bookwalter,* 427 F.2d 1341 (8th Cir. 1970), *cert. denied,* 405 U.S. 1045 (1972), this Court anticipated the result of a later Supreme Court decision involving identical facts, *United States v. Mississippi Chemical Corp.,* 405

U.S. 298 (1972). In *Mississippi Chemical*, the Supreme Court based its characterization of capital stock as a capital asset solely on the language of section 1221, and ignored its previous decision in *Corn Products* entirely. Under the Farm Credit Act of 1933, 12 U.S.C. § 1134 *et seq.*, the taxpayers were required to make quarterly purchases of the stock of the regional Bank for Cooperatives (Regional Bank) in amounts tied to their interest payments to the Regional Bank. On their tax returns, the taxpayers claimed interest expense deductions for the stock. The Supreme Court held that since the stock was "of value in more than one taxable year, it is a capital asset within the meaning of § 1221 of the Internal Revenue Code, and its cost is nondeductible." 405 U.S. at 310.

In *M.F.A. Central Cooperative*, the taxpayers similarly were required under the Farm Credit Act of 1933 to invest in capital stock of the Regional Bank in an amount dependent upon the interest they owed on their Regional Bank loans. In deciding the case, this Court, like the Supreme Court later, relied upon the plain language of section 1221 and found that the stock fully met the definition of capital asset and did not satisfy any of the section 1221 exclusions. 427 F.2d at 1343. Our Court therefore held that the stock was a capital asset and that the purchase price could not be considered an ordinary business expense. *Id.* at 1344.

Although *Mississippi Chemical* and *M.F.A. Central Cooperative* deal with the tax treatment of the acquisition cost of capital stock rather than the tax treatment of gains or losses upon the disposition of capital stock, we find no principled basis upon which to distinguish those cases from the present case. We thus hold that Arkansas Best's losses upon disposition of the Bank stock are not entitled to ordinary loss treatment, regardless of when or why the stock was acquired.

We acknowledge that in post-*Corn Products* decisions some federal courts have taken the position that capital stock is not a capital asset when acquired to assure a supply of raw materials vital to the taxpayer's business, to preserve an existing business, or even to pursue new business. Note, *The Corn Products Doctrine*

and Its Application to Partnership Interests, 79 Colum. L. Rev. 341, 343 (1979); Troxell & Noall, *supra,* at 196-207. A test that some courts apply is the business purpose-investment purpose test: capital stock acquired for business purposes is classified as an ordinary asset, and capital stock acquired for investment purposes is classified as a capital asset. *See Booth Newspapers v. United States,* 303 F.2d 916, 921 (Ct. Cl. 1962); *Dearborn Co. v. United States,* 444 F.2d 1145, 1166 (Ct. Cl. 1971). Other courts have rejected this test, at least for situations in which the taxpayer had mixed motives for acquiring the asset, and have replaced it with a substantial investment purpose test. Note, *supra,* at 347. *See, e.g., W. W. Windle Co. v. Commissioner,* 65 T.C. 694, 703-04 (1976), *appeal dismissed,* 550 F.2d 43 (1st Cir. 1977), *cert. denied,* 431 U.S. 966 (1977); *Wright v. Commissioner,* 756 F.2d 1039, 1041-42 (4th Cir. 1985). Under this test, property is treated as an ordinary asset only if the taxpayer bought and retained it without a substantial investment purpose. Note, *supra,* at 347; *see W. W. Windle,* 65 T.C. at 712, 713, 714 n.15. With all due respect to these courts, it is clear to us that both tests lack a basis in the statutory language, and we reject them.

The case most closely analogous to the one before us is the Fifth Circuit's decision in *Campbell Taggart,* 744 F.2d at 442. There, a holding company that derived its income from service fees and dividends from its subsidiaries negotiated the purchase of the capital stock of a supermarket chain in Spain. Before the purchase was consummated, Campbell Taggart discovered problems in the chain's financial condition and decided to sell the 25% interest it previously had acquired during the negotiations. It nevertheless proceeded with the final purchase agreement and purchased an additional 25% interest as the parties originally had contemplated. Selling the stock at a substantial loss thereafter, it claimed an ordinary deduction for the loss incurred. Campbell Taggart argued that it consummated the final purchase only to protect its good will and reputation, and that "because it lacked an investment motive . . . the stock, which all agree is normally a capital asset, was an ordinary asset under the *Corn Products* doctrine." *Id.* at 446 (footnote omitted). The Fifth Circuit

concluded that stock is entitled to ordinary asset treatment when there is no investment purpose and it was acquired as an indirect means of incurring otherwise deductible business expenses. *Id.* at 451. The court held that "the *Corn Products* doctrine is triggered by a finding of business purpose, as opposed to investment purpose, in acquiring what would otherwise be a capital asset." *Id.* at 458.

For the reasons delineated above, we do not agree with the Fifth Circuit's interpretation of section 1221. We do not read *Corn Products* as either requiring or permitting the courts to decide that capital stock can be anything other than a capital asset under section 1221. It seems to us that one of the last places where the legal system deliberately should foster subjectivity and uncertainty is in the tax code. *Corn Products* and its progeny, which we respectfully view as misbegotten, have done precisely that, leading to increased recourse to the administrative and judicial processes to resolve conflicting contentions about taxpayers' motivations in purchasing capital stock. Congress could have written section 1221 to incorporate some sort of exception regarding capital stock, just as it recognized the unique position of securities dealers in 26 U.S.C. § 1236, but it did not do so. We believe that the judiciary lacks authority to create exceptions to section 1221 that Congress did not choose to make.

III.

The final issue is whether the Tax Court properly ruled that Arkansas Best was not entitled to a partial bad debt deduction for 1975 based on its write-down of the nonrecourse note it received as partial consideration for its sale of Bank stock to the Texas investors. "The question whether a taxpayer may take a partial bad debt deduction is . . . committed to the sound discretion of the Commissioner, and his judgment is controlling unless it is plainly arbitrary or unreasonable." *Wilson Brothers & Co. v. Commissioner,* 124 F.2d 606, 609 (9th Cir. 1941). The burden is on the taxpayer to prove the worthlessness of the debt in the year claimed. *Record Wide Distributors v. Commissioner,* 682 F.2d

204, 207 (8th Cir. 1982), *cert. denied,* 459 U.S. 1171 (1983). Our review of the Tax Court proceeding is limited to determining whether substantial evidence exists to support the court's decision. *Riss v. Commissioner,* 478 F.2d 1160, 1164 (8th Cir. 1973). We conclude that there is substantial evidence to support the Tax Court's ruling that the Commissioner did not abuse his discretion in disallowing this deduction.

IV.

For the reasons stated above, we reverse the judgment of the Tax Court to the extent that it grants Arkansas Best ordinary loss treatment for the losses it incurred on Bank stock purchased after 1972 and on Bank stock purchased from the Bank president in 1972. In all other respects, the judgment of the Tax Court is affirmed.

HANSON, Senior District Judge, dissenting.

I must dissent to section II of the Court's opinion. The majority opinion scorns *Corn Products* and its progeny as fostering uncertainty in taxpayers' motivations in purchasing capital stock, favoring instead a return to the literal meaning of section 1221. The majority therefore falls in line with those critical of all *Corn Products* has wrought.

It appears to me, however, that *Corn Products* was merely an attempt to divine congressional intent. As such, it is a compelling rejoinder to those who believe "that legislative draftsmen and the tax-writing committees of the Congress are the most desirable forum for illuminating a subject matter they themselves made obscure and interminable." Javaras, "Corporate Capital Gains and Losses — The *Corn Products* Doctrine, 52 Taxes 770, 794 (1974).

After it announced in 1971 that it would divest its Bank holdings, Arkansas Best was compelled to infuse capital into the Bank in order to preserve its equity in the Bank. It is therefore apparent that, consistent with *Corn Products,* the stock was

purchased as an integral and necessary act in the conduct of Arkansas Best's business as a holding company. *See Booth Newspapers, Inc. v. United States*, 303 F.2d 916, 921 (Ct. Cl. 1962).

Nor am I convinced that this Circuit has in the past narrowly construed *Corn Products. Municipal Bond Corp. v. Commissioner*, 341 F.2d 683 (8th Cir. 1965), specifically did not narrow *Corn Products*, but rather dealt only with the plain meaning of the unambiguous word "primarily." *Id.* at 668. In addition, *M.F.A. Central Cooperative v. Bookwalter*, 427 F.2d 1341 (8th Cir. 1970), *cert. denied*, 405 U.S. 1045 (1972), cannot support the majority's conclusion that this Circuit follows the plain meaning of section 1221 in all cases. Indeed, the focus in *M.F.A. Cooperative* had to do with stock which at no point could be said to have been worthless; rather, the Court found dispositive the fact that the stock had substantial value. *Id.* at 1343-44. There can be no doubt that in this case purchases after 1972 were at a substantial loss, and were an attempt to avoid liquidation of the Bank and to preserve the insurance license of its subsidiary, Universal.

I therefore would hold that Arkansas Best was entitled to ordinary loss treatment on its purchase of stock after 1972.

A true copy.

Attest:

CLERK, U. S. COURT OF APPEALS, EIGHTH CIRCUIT.

83 T. C. No. 35
United States Tax Court

ARKANSAS BEST CORPORATION and SUBSIDIARIES, *Petitioner v.* COMMISSIONER OF INTERNAL REVENUE, *Respondent*

Docket No. 18954-80. Filed October 29, 1984.

In 1968, petitioner ABC, a diversified holding company, acquired approximately 65 percent of the stock of NBC, a bank. The transaction was intended by ABC and accepted by the Internal Revenue Service as a tax-free corporate reorganization under sec. 368(a)(1)(C), I.R.C. 1954. ABC acquired additional shares of NBC stock during the period 1969-1976 by purchase, capital calls and stock dividends.

Legislation enacted by Congress subsequent to 1968 regulating bank holding companies effectively required ABC to divest itself of the NBC stock. ABC sold 51 percent of NBC's stock in 1975 for cash and a note secured by the stock. ABC disposed of its remaining interest in NBC over the following five years.

Held, the acquisition of NBC stock by ABC during the period 1968-1972 was motivated primarily by investment purpose and consequently ABC realized a capital loss upon disposition of the stock. *Held further*, ABC's acquisition and retention of NBC stock during the years 1973-1976 was exclusively for business purposes and thus ABC incurred an ordinary loss from the sale of NBC stock acquired during this later period. *W. W. Windle Co. v. Commissioner*, 65 T.C. 694 (1976), appeal dismissed 550 F.2d 43 (1st Cir. 1977), followed.

Held further, ABC is barred from asserting under the doctrine of "duty of consistency" that its acquisition of 65 percent of the stock of NBC in 1968 was not a tax-free reorganization under sec. 368(a)(1)(C), I.R.C. 1954. *Bartel v. Commissioner*, 54 T.C. 25 (1970), followed.

Held further, ABC is not entitled to deduct as a partially worthless debt its charge off of a portion of the note received from the sale of NBC stock.

Vester T. Hughes, Jr., David F. P. O'Connor, Eric R. Cromartie, and *Stephen D. Good,* for the petitioner.

Raymond L. Collins, and *Rebecca W. Wolfe,* for the respondent.

NIMS, *Judge:* Respondent determined deficiencies in petitioner's Federal income tax as follows:

Year	Deficiency
1969	$ 20,224
1970	20,224
1971	50,560
1972	3,355,968
1973	244,352
1974	230,519
1975	928,911
1976	2,077,163

After concessions, the issues presented for decision are (1) whether petitioner's loss on the sale of its controlling interest in a bank is ordinary or capital loss, (2) whether the bank stock was acquired in a transaction qualifying as a tax-free reorganization under section 368(a)(1)(C),[1] and (3) whether petitioner is entitled to a bad debt deduction for the partial charge-off of a note acquired in connection with the sale of the bank stock.

FINDINGS OF FACT

Some of the facts have been stipulated and are found accordingly.

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[1] All section references are to the Internal Revenue Code of 1954, as in effect for the years in issue, unless otherwise indicated. All rule references are to the Tax Court Rules of Practice and Procedure, except as noted.

Petitioner had its principal office in Fort Smith, Arkansas, at the time the petition in this case was filed.

Arkansas Best Freight System, Inc. (ABF) is a successful trucking line operating in the midwestern United States. During its early existence, ABF grew primarily by acquiring established trucking companies. In the early 1960's, ABF's banker, First National City Bank (now "Citibank"), suggested that a holding company be formed to facilitate acquisitions and avoid various restrictions which accompanied the truckline's regulation by the Interstate Commerce Commission (ICC).

In March, 1966, Arkansas Best Corporation (hereinafter Arkansas Best or petitioner), was formed as a holding company. The management and control of Arkansas Best resided with Robert A. Young, Jr. (Young) and members of his family. Arkansas Best immediately embarked on a program of expansion with a plan of ultimately becoming a diversified conglomerate.

The envisioned conglomerate was to be composed of businesses from three sectors of the economy: transportation, consumer goods and financial services. Transportation was already represented by ABF, the trucking line. In rapid succession, Arkansas Best then acquired Riverside Furniture Corporation (Riverside), a company engaged in furniture manufacturing, distribution and sales, and Data-Tronics, a company which offered data processing services.

Riverside was to be the core of the consumer goods sector of the conglomerate. Data-Tronics was acquired for a slightly different reason. Arkansas Best desired the aid of a computer in the trucking business but could not afford the cost of the necessary computer. The acquisition of Data-Tronics permitted Arkansas Best to have use of a computer while marketing its services to third parties to reduce costs. Data-Tronics devoted approximately one-half of its services to the needs of Arkansas Best and its subsidiaries.

Arkansas Best then established Arkansas Bandag Corporation (Bandag), a company engaged in new tire sales and tire re-

treading. Bandag also held title to the real estate of Arkansas Best and the other subsidiaries. Initially, ABF (the trucking subsidiary) represented up to one-half of Bandag's tire business but that percentage had declined to approximately five percent by the time of trial.

In the financial services area, Arkansas Best acquired Universal Insurance Company (UIC) and Arkansas Underwriters Corporation (AUC). The companies were useful for the truckline which was "a high utilizer of insurance."

These five subsidiaries — ABF, Riverside, Data-Tronics, Bandag, UIC and AUC — were wholly owned by Arkansas Best. Arkansas Best provided financial planning and, in some cases, accounting and personnel services to its subsidiaries. In return, the companies paid a management fee to Arkansas Best.

From the date of Arkansas Best's incorporation in 1966 until his death in August, 1973, Robert A. Young served as chairman of the board of Arkansas Best. During the period from March, 1967, to April, 1968, Young personally acquired the following stock and security interests in National Bank of Commerce (NBC), a bank located in Dallas, Texas:

Interest	Book Value
Capital Convertible Debentures of NBC	$ 742,600
Contract to purchase 24,534 shares of convertible preferred stock of NBC	1,145,700
209,013 shares of common stock of NBC	5,798,196
Total:	$7,686,496

On June 6, 1968, Young transferred these interests to Young, Inc., a personal holding company incorporated by Young three weeks earlier. These interests, plus $1,000 cash, constituted the assets of Young, Inc.

Three weeks later, on June 29, 1968, Young, Inc. transferred to Arkansas Best all of its stock and securities in NBC. In return, Young, Inc. received 150,000 shares of Series "C" Convertible

Preferred Stock of Arkansas Best[2] plus the assumption by Arkansas Best of Young, Inc.'s liabilities which totaled $7,686,995. The Internal Revenue Service accepted the transaction as a tax-free reorganization.

As a result of the foregoing transaction, Arkansas Best owned 266,614 shares of NBC common stock at the end of 1968.[3] These shares represented 64.97 percent of the outstanding common stock of NBC at that time.

In connection with its acquisition of the bank's stock, Arkansas Best obtained three appraisals of NBC's stock from unrelated investment banking firms. It also obtained five eight-year forecasts from Citibank projecting the expected growth and earnings of the bank.

At the time Arkansas Best acquired the bank stock, Arkansas Best was aware that there were bills pending in Congress which, if enacted, might impact upon its holding of NBC stock. In a notice to shareholders calling a special meeting for June 29, 1968, concerning the proposed acquisition of NBC stock, a proxy statement was included which informed shareholders of the following:

> Bills affecting banking are pending in Congress. The Company is unable to predict whether any such bills will be passed or the effect on the Company's or NBC's business if one or more such bills were passed. However, one such bill, if passed, would amend the Bank Holding Company Act of 1956 to provide that the Company, by virtue of its ownership of NBC shares, would be a bank holding company. With certain exceptions, such Act requires bank holding companies to divest themselves of direct or indirect ownership of voting shares of companies which are not either banks or bank holding compa-

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[2] The stipulated fair market value of the 150,000 shares at the time of the transfer was $1,500,000.

[3] Earlier in 1968, Arkansas Best had separately acquired 3,363 other shares of NBC at a cost of $86,128.

nies. A bank holding company is also prohibited, with limited exceptions, from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company which is not a bank or from engaging directly or indirectly in business unrelated to the business of banking or controlling banks.

Arkansas Best has a number of reasons for acquiring the stock of NBC. First, the city of Dallas was developing rapidly as a financial center and banks were at the center of the boom. NBC appeared likely to share in this growth and the value of its stock was therefore likely to appreciate.

Second, Arkansas Best planned to make a public offering of its stock. Under generally accepted accounting principles, Arkansas Best could not include NBC, a bank, in the consolidated financial statements of Arkansas Best and its nonbanking subsidiaries. Under the so-called equity method of accounting, however, Arkansas Best was permitted to reflect a pro rata portion (i.e., approximately 65 percent) of NBC's earnings in its financial statements contained in the offering materials. This practice of one-line equity consolidation of earnings was available at the time to any corporate shareholder which owned 20 percent or more of another corporation.

An additional benefit received by ABC was an increase in its aggregate price/earnings ratio. Because banks enjoy relatively high price/earnings ratios compared to certain of Arkansas Best's subsidiaries, Arkansas Best's acquisition of NBC increased its aggregate price/earnings ratio. The higher price/earnings ratio consequently enabled Arkansas Best to obtain a higher price for its shares in the public offering.

Other subsidiary benefits to Arkansas Best from the acquisition of NBC's stock were prestige and acceptance in the Dallas financial community because of association with the bank, added protection from hostile takeover attempts because the bank was subject to federal regulation, and, finally, improved access to financing because the bank stock represented attractive collateral.

NBC did not, however, interact with the Arkansas Best and its subsidiaries in the same way the subsidiaries and Arkansas Best interacted with each other. NBC offered no financing to Arkansas Best or its subsidiaries. Moreover, NBC contributed very little to the conglomerate by way of earnings distributions. Banks typically pay low dividends because they are subject to strict capital retention requirements.

Arkansas Best supplied no management services to NBC and consequently received no management fees from NBC. At any one time, Arkansas Best had no more than three representatives on NBC's Board of Directors which on the average consisted of 20 members. In any event, NBC's Board of Directors had very limited influence over management decisions at the bank because its review was restricted to actions already taken.

On December 31, 1970, Congress enacted the 1970 Amendments to the Bank Holding Company Act. Under the statute and the regulations promulgated thereunder, Arkansas Best was deemed to be "in control" of NBC for purposes of the Bank Holding Company Act, and therefore to be a "bank holding company" as defined in that Act.

Status as a bank holding company required Arkansas Best to either (1) cease making acquisitions of new lines of non-banking businesses or of going-concern acquisitions in its existing lines of non-banking businesses, or (2) divest itself of its entire interest in the bank.

Arkansas Best chose the second alternative and, on July 30, 1971, it filed an irrevocable declaration of divestiture with the Federal Reserve Bank of Dallas. The notice of divestiture declared that Arkansas Best would divest itself of control of NBC by January 1, 1981. Once the notice was filed, Arkansas Best was free to make acquisitions of non-banking businesses.

Arkansas Best carried the bank stock on its financial records as an "investment." As noted previously, generally accepted accounting principles prevented Arkansas Best from including NBC as part of its consolidated group.

In corporate documents, Arkansas Best made repeated references to NBC as an investment. For example, attached to the minutes of the quarterly and annual meeting of the Board of Directors of Arkansas Best, held May 17, 1972, was a "Statement of Corporate Objectives" which included the following goals (emphasis added):

ABC Corporate Structure Viz Diversification

1. Three major components to corporate earnings each subject to separate economic forces and business risks.
2. No single factor to contribute more than 50 percent of revenues as a long run corporate strategy.
3. Direct management control of subsidiaries *(e.g., National Bank of Commerce now treated as an investment of the holding company from an operational standpoint)*.
4. Exploit additional growth potential in trucking, furniture, Bandag and Data-Tronics both internally and by acquisition.

During the period from 1969 through 1974, Arkansas Best participated in a number of capital calls made by NBC in response to concerns of federal regulators that NBC was not adequately capitalized. Also during this period, Arkansas Best acquired additional shares of NBC through stock dividends, purchase and conversion of debentures. These transactions are summarized as follows:

Year	No. Shares Acquired	Cost	Transaction
1969	142,670	$ 3,639,266	Two capital calls
	24,188	723,928	Purchase
1970	—	—	—
1971	43,347	—	Stock dividend
1972	19,072	—	Stock dividend
	95,363	2,407,915	Capital Call
	6,165	616,500	Purchase
1973	23,902	—	Stock dividend
	103,887	2,077,740	Capital Call
	135	13,500	Purchase
	8% Conv. Deb.	3,116,610	Capital Call
1974	124,664	—	Conversion of debentures
	2,402	61,946	Purchase
Total	585,795	$12,657,405	

At the end of 1974, Arkansas Best owned 852,409 shares of the common stock of NBC which represented 65.77 percent of the stock then outstanding.

From 1968 until 1972, the bank appeared to be successful and growing. The capital calls during this period were made to accommodate this growth.

In 1972, Arkansas Best commenced negotiations with Texas Commerce Bancshares to divest itself of the NBC stock in a stock exchange on terms favorable to Arkansas Best. Representatives of Texas Commerce Bancshares examined the loan portfolio of NBC and discovered serious problems. Texas Commerce Bancshares withdrew from the negotiations.

Federal examiners then undertook their own investigation of NBC's financial position. Weak loans in a bank's portfolio are denoted as such by four classifications assigned by the examiners. In order of increasing gravity, the classifications are (1) loans especially mentioned, (2) substandard loans, (3) doubtful loans and (4) loss loans. When a bank has more than 50 percent of its loan portfolio classified as weak loans, the bank is considered a problem bank.

NBC was considered to be a problem bank from 1973 through approximately 1977. The difficulties stemmed primarily from a heavy concentration of loans in the local Dallas real estate industry which suffered a severe collapse at about that time.

In July, 1974, Arkansas Best still held out hope of disposing of the NBC stock at a profit and apparently expected capital gain treatment on such a transaction. The minutes of the Board of Directors meeting for that month summarized the following report by the company's general counsel, Mr. Harper:

> [The Chairman of the Board] stated that he had discussed the desirability of disposing of the company's 60% interest in National Bank of Commerce of Dallas with individual directors and they wished to retain the services of Goldman, Sachs and Company, investment bankers, to assist and advise in efforts to divest NBC.
>
> Mr. Harper reviewed the tax treatment of a one-bank holding company in forced divestiture, stating legislation had been proposed in Congress that banks in such circumstances would not receive rollover tax treatment with no capital gains, but hopefully there would be granted a ten-year period in which to spread the capital gain, or until 1985, whichever comes first. He said we hoped for a method where if the bank would be divested and the money or assets received be invested in a new asset, the capital gain would be delayed until the new asset was disposed of. * * *

The capital calls issued by NBC after 1972 were in response to the loan portfolio problems of the bank. Arkansas Best participated in these capital calls for a number of reasons. First, participation of the controlling shareholder was essential to save the bank and thus Arkansas Best was compelled to participate if it wished to preserve its equity in the bank. Second, failure to participate with the resultant demise of the bank exposed Arkansas Best to litigation by the minority shareholders. Third, permitting the bank to fail would reflect badly on Arkansas Best so that

its sources of financing might be jeopardized and its reputation for skilled management might be tarnished.

On June 30, 1975, Arkansas Best finally sold the bulk of its holdings in NBC stock. It sold 661,000 shares to a group of 63 Texas investors (the "Brooks group"), a block of stock which constituted 51 percent of the outstanding common stock of NBC.

In exchange, Arkansas Best received (1) $1,059,914 in cash, and (2) a note with a face amount of $6,006,176, secured by the 661,000 shares of stock (the "Note"). The fair market value of the Note on June 30, 1975, was $4,878,088.

By December, 1975, it appeared likely that NBC would require even greater infusions of capital than contemplated at the sale. The Brooks group approached Arkansas Best, which still owned 14.7 percent of NBC's outstanding stock, to solicit financial assistance. Arkansas Best refused to make any more efforts to rescue the bank but consented to subscribe to 14.7 percent of the next capital call.

At its directors meeting of December 20, 1975, however, Arkansas Best did accept in principle a compromise suggestion advanced by the Brooks group. The Brooks group suggested that the Note should be sold to some third party who could more certainly assist with NBC's capital needs.

On January 21, 1976, Arkansas Best made a book entry writing down the value of the Note by $4,485,876. The Note was not in default at this time but the directors of Arkansas Best had received some indications that the Brooks group might have some difficulties in honoring its obligation. The accounting entry was made to reflect the underlying book value of the NBC stock securing the Note.

One member of the Brooks group ultimately located a buyer for the Note held by Arkansas Best. On February 9, 1976, Arkansas Best executed a memorandum of agreement with the prospective buyer, Coke L. Gage (Gage). On April 7, 1976, Arkansas Best sold the Note to Gage for $1,652,500. As a condition of this sale,

Arkansas Best acquired an additional 573,953 shares of NBC's common stock in a capital call for $1,233,999.[4]

At approximately the same time as the sale of the Note to Gage, Arkansas Best granted William R. Riley (Riley) an option to purchase its remaining 765,362 shares of NBC stock in annual installments through 1980. Riley or his assignees exercised these options rights as follows:

Year	No. Shares Purchased	Price
1976	15,000	$ 33,000
1977	50,000	110,000
1978	215,226	473,497
1979	215,226	473,497
1980	269,910	593,802
Total:	765,362	$1,683,796

At the close of these transactions, Arkansas Best owned no shares of NBC stock nor any other stock or security interest in NBC.

OPINION

This case raises the question whether the loss realized on the sale of stock by a conglomerate may be characterized as ordinary loss under the Supreme Court's decision in *Corn Products Refining Co. v. Commissioner,* 350 U.S. 46 (1955).

Petitioner is a holding company whose only assets are the stock and securities of other corporations. The holding company is the nucleus of a diversified conglomerate with subsidiaries engaged in the businesses of transportation, consumer goods and financial services.

In 1968, petitioner acquired a controlling interest (approximately 65 percent of the outstanding common stock) in a bank located in Dallas, Texas, The National Bank of Commerce

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[4] In connection with the sale, Arkansas Best incurred sales expenses of $33,050 and legal fees of $5,050.

(NBC). In 1970, Congress enacted certain amendments to the Bank Holding Company Act of 1956, the net result of which was to classify petitioner as a bank holding company by virtue of its ownership interest in NBC.

Status as a bank holding company put petitioner to the following choice: (1) cease making acquisitions of nonbanking businesses, or (2) divest itself of the NBC stock. Petitioner chose the second alternative and, in 1971, filed an irrevocable declaration of divestiture with the Federal Reserve Bank of Dallas which guaranteed divestiture by 1981.

Petitioner sold 51 percent of NBC's outstanding stock in one block in 1975. It disposed of the remaining 14.7 percent in installments over the following five year pursuant to an option granted in 1975. On its Federal income tax return for 1975, petitioner claimed an ordinary loss of $9,995,688 from the disposition of NBC stock.

Section 1221 defines the term "capital asset" to mean any property held by the taxpayer with certain enumerate exceptions. In *Corn Products*, the Supreme Court observed that "[t]he preferential treatment provided by [section 1221] applies to transactions in property which are not the normal source of business income." *Corn Products Refining Co. v. Commissioner, supra*, 350 U.S. at 52. The Court further observed that "[s]ince this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly."

In *Corn Products*, the Court was confronted with transactions which appeared to be ordinary and not capital despite the fact that the property involved did not properly come within any of the exclusions set out in section 1221. The taxpayer in that case was a company engaged in converting corn into starch, syrup and other products. To assure its supply of corn and protect itself against increases in the price of corn, the taxpayer regularly purchased and sold corn futures. The Supreme Court held that losses sustained on these transactions warranted ordinary loss treatment

because Congress intended "that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss." *Corn Products Refining Co. v. Commissioner, supra* at 52.

This judicially-created addition to the exclusions set out in section 1221 was subsequently expanded by the lower courts to include, under certain circumstances, irregular or unique transactions such as dispositions of stock. The principles governing the application of the *Corn Products* doctrine to the sale of securities were summarized by the Court of Claims in a leading case as follows:

> [I]f securities are purchased by a taxpayer as an integral and necessary act in the conduct of his business, and continue to be so held until the time of their sale, any loss incurred as a result thereof may be fully deducted from gross income as a business expense or ordinary loss. If, on the other hand, an investment purpose be found to have motivated the purchase or holding of the securities, any loss realized upon their ultimate disposition must be treated in accord with the capital asset provisions of the Code.
>
> Thus, the circumstances of the transaction (its factual background, the necessities of the particular business involved at the particular time involved, and the intentions of the taxpayer, both at the time the securities were originally purchased and at the time they were disposed of) are of crucial importance in the resolution of these cases. The fact that securities are "property," in the broad sense of that term, is not conclusive.

Booth Newspapers, Inc. v. United States, 157 Ct. Cl. 886, 303 F.2d 916, 921 (1962).

In this case, we must first resolve a threshold issue in order to apply the principles set out above: What is the trade or business of petitioner holding company, if, indeed, a holding company can have a trade or business as that term is used in the Internal Revenue Code?

The term "trade or business" is not defined in the Internal Revenue Code nor in the regulations nor by an authoritative judicial definition in the case law. In 1941, the Supreme Court held that the management of securities by an individual for his own account, even through an elaborate operation requiring an office and staff, was not a trade or business for purposes of section 162. *Higgins v. Commissioner*, 312 U.S. 212 (1941). See *Whipple v. Commissioner*, 373 U.S. 193, 202-3 (1963); *Bodzy v. Commissioner*, 321 F.2d 331 (5th Cir. 1963); *United States v. Byck*, 325 F.2d 551 (5th Cir. 1963); *Deely v. Commissioner*, 73 T.C. 1081 (1980); *Moller v. United States*, 721 F.2d 810 (Fed. Cir. 1983).

The *Higgins* decision prompted the enactment of the predecessor to section 212. Congress sought to permit taxpayers to deduct ordinary and necessary expenses incurred for the production or collection of income or for the management, conservation or maintenance of property held for the production of income. By its terms, section 212 applies only "[i]n the case of an individual • • •." The failure of Congress to include corporations in the coverage of that section gives rise to a negative implication that all corporations necessarily have a trade or business and, accordingly, do not require the aid of section 212 in order to deduct expenses incurred for the production of income.[5]

Petitioner contends that it is in the trade or business of acquiring and managing going concerns in diverse yet complementary lines of business. Although at first impression it may appear that the acquisition and management of stock holdings in other business constitutes activity peculiarly like that of an investor, there is judicial support for characterizing such activity

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[5] See B. Bittker, Federal Taxation of Income, Estates and Gifts, par. 20.1.2 (1981): "As for corporations, the fact that Congress did not include them in IRC section 212 suggests the possibility that the term 'trade or business' as used by IRC section 162 was thought to be broad enough to embrace a corporation's activities in managing its own investments."

as a trade or business. In a case which squarely addressed this question, the Court of Claims considered what, if any, was the business of Allied Chemical, a holding company:

> The parties have agreed that the acquisition of the stock in American was a part of Allied's business, which at that time was confined to the holding of stocks in other companies. What does the business of a holding company consist of? Briefly stated, it consists of conserving and protecting its holdings, influencing, or directing when it can, the management of the companies in which it holds stock, so as to increase the value of its holdings and the income to be derived therefrom, the collection of dividends, the advantageous disposition of stocks in companies with whose management it is not satisfied; or where it appears desirable to do so, and reinvesting the proceeds, etc.

Allied Chemical Corporation v. United States, 158 Ct. Cl. 267, 305 F.2d 433, 437 (1962).

In another analogous case, this Court found a closed-end investment company to be in a trade or business:

> [Stock] was a part of petitioner's stock in trade as a closed-end investment company. To protect this investment was well within the scope of its business, which consisted of investment in, and management of, securities of other corporations.

Alleghany Corporation v. Commissioner, 28 T.C. 298, 303 (1957).

We accept that petitioner, as a holding company, was in a trade or business defined as the acquisition and management of going concerns in diverse yet complementary lines of business. Our inquiry then, as framed by *Booth Newspapers*, is whether petitioner purchased and held the stock of NBC as an integral and necessary act in the conduct of that business or whether the stock was purchased or held with an investment purpose.

When a taxpayer harbors mixed motives of investment and business purpose, as is often the case, the rule is now settled that "stock purchased with a substantial investment purpose is a capital asset even if there is a more substantial business motive for the purchase." *W. W. Windle Co. v. Commissioner,* 65 T.C. 694, 712 (1976), appeal dismissed 550 F.2d 43 (1st Cir. 1977). Compare *Dearborn Co. v. United States,* 195 Ct. Cl. 219, 444 F.2d 1145 (1971) and *Agway, Inc. v. United States,* 207 Ct. Cl. 682, 524 F.2d 1194 (1975) with *Union Pacific Railroad Co., Inc. v. United States,* 208 Ct. Cl. 1, 524 F.2d 1343 (1975).[6]

When a taxpayer's motive changes between the time of purchase and the time of disposition, whether from investment purpose to business purpose or from business purpose to investment purpose, the character of the gain or loss at disposition of the stock will be capital. This rule "illustrates the fact that corporate stock is normally a capital asset, and that only where both original purpose of acquisition and the reason for continued retention are both devoid of substantial investment intent should the stock be treated otherwise." *W. W. Windle Co. v. Commissioner, supra,* 65 T.C. at 714 n. 15.

In short, the business purpose must persist, without a substantial investment purpose, throughout the purchase and holding period if the gain or loss is to be characterized as ordinary under the *Corn Products* doctrine.

In this case, the acquisition of NBC stock by petitioner may be viewed in two stages: (1) the initial acquisition of a 65 percent interest in 1968, plus the acquisition of additional shares by purchase, capital calls, and stock dividends during the "growth" phase (1969-1972) of the holding period, and (2) the acquisition

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[6] As noted in *W. W. Windle Co. v. Commissioner,* 65 T.C. 694, 710 (1976), the Court of Claims' decision in *Union Pacific Railroad Co., Inc. v. United States,* 208 Ct. Cl. 1, 524 F.2d 1343 (1975) may be viewed as casting doubt on the vitality of *Dearborn Co. v. United States,* 195 Ct. Cl. 219, 444 F.2d 1145 (1971) and *Agway, Inc. v. United States,* 207 Ct. Cl. 682, 524 F.2d 1194 (1975).

of additional shares by purchase, capital calls and stock dividends during the "problem" phase (1973-1976) of the holding period. Arkansas Best's reasons for acquiring and holding the stock in each instance were different.

We find that the acquisitions of NBC stock over the period from 1968 to 1972 were motivated primarily by investment purpose and only incidentally by some business purpose.

Arkansas Best was aware of the rapid development of Dallas, Texas, as a financial center during the early 1960's and was eager to take advantage of the boom. Banks were at the center of the expansion and NBC appeared likely to share in the benefits. Arkansas Best viewed NBC as an attractive investment.

Arkansas Best obtained several appraisals of NBC and forecasts of the bank's earnings. The prospects were very appealing. Had these projections been realized, Arkansas Best's investment in NBC would have experienced strong appreciation. This Court in *W. W. Windle* found projections such as these to bear on investment purpose:

> These projections make it impossible for us to find that there was no substantial investment motive. Had the projections been realized, Nor-West would have been a good investment.

65 T.C. at 705. See *Datamation Services, Inc. v. Commissioner,* T.C. Memo. 1976-252.

The business purposes asserted by petitioner were at most secondary to the investment purpose, e.g., enhancing Arkansas Best's stock price in a planned public offering, prestige in the Dallas financial community and added protection against hostile takeover attempts.

Moreover, Arkansas Best held the stock in such a way as to belie any business purpose at all. NBC was the only subsidiary not wholly owned by Arkansas Best and was never integrated into the "complementary group" of businesses governed by Arkansas Best. The bank was not permitted to supply financing to Arkansas

Best or its subsidiaries and Arkansas Best did not supply management services to or receive a management fee from the bank. The bank contributed very little to the conglomerate by way of earnings distributions. Finally, Arkansas Best exercised very limited influence over the bank's management and, at any one time, never had more than three representatives on NBC's 20-man Board of Directors.

In contrast, the other subsidiaries often acted as suppliers and customers for one another, paid management fees to Arkansas Best, contributed substantial capital to the conglomerate's use, operated under entensive control from Arkansas Best and otherwise existed as integral and complementary units of the conglomerate. See *Booth Newspapers, Inc. v. United States, supra; Union Pacific Railroad Co., Inc. v. United States, supra.*

The divestiture notice in 1971 finally eliminated any remaining prospect of bringing NBC into the complementary system of companies comprising the conglomerate. The directors of Arkansas Best had been aware of this possibility even when the NBC stock was initially acquired in 1968.

The fact that NBC's special status as a bank in part foreclosed its integration into the conglomerate does not alter the hard reality of its separate and distinct character as an investment holding. The bank was not an integral and necessary part of Arkansas Best's business. The actual relationship, not the hoped for or potential relationship, determines whether an asset is part of the everyday operations of the business.

Accordingly, under the principles articulated in *W. W. Windle,* we hold that the character of the loss realized on the disposition of the NBC shares of common stock acquired in the years 1968 through 1972 is capital loss.[7]

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[7] We note in passing that during the time when Arkansas Best still hoped to realize a gain on the sale of NBC pursuant to the divestiture declaration, the directors of Arkansas Best apparently expected the gain to be capital gain. See Findings of Fact, *supra.*

We turn then to the shares of NBC stock acquired by Arkansas Best in the years 1973 through 1976. The reasons for these purchases differed significantly from the reasons for the earlier purchases. We find that these later purchases were made exclusively for business purposes and subsequently held for the same reasons.

After 1972, the bank's poor financial health became alarmingly apparent to Arkansas Best. Because of these difficulties, NBC experienced a need for substantial capital infusions. The probable consequence of Arkansas Best not participating in the capital calls during this period would have been the demise of the bank.

Owning a controlling interest in a bank — a highly regulated, peculiarly public institution — imposed a special responsibility on Arkansas Best. After 1972, Arkansas Best acquired additional shares of NBC stock to meet this obligation and protect its own business reputation.

As a growing conglomerate, Arkansas Best depended upon its good reputation with creditors in order to assure a reliable source of financing for acquisitions. In addition, Arkansas Best's reputation as a conglomerate especially skilled in management determined its standing with other businessmen and in the stock market. (Arkansas Best was listed on the American Stock Exchange beginning in 1969 and on the New York Stock Exchange beginning in 1972.) Association with the failure of a bank would have severely blemished Arkansas Best's reputation in the financial and business communities in which it operates.

Moreover, the demise of the bank would have exposed Arkansas Best (as controlling shareholder) to potentially damaging and costly litigation by minority shareholders.

Expenditures to preserve business reputation are typically currently deductible business expenses. *Dunn & McCarthy, Inc. v. Commissioner,* 139 F.2d 242 (2d Cir. 1943). The purchase of stock may be a necessary tactic in the protection of business reputation, and in certain narrow circumstances may invoke the doctrine of *Corn Products.*

Arkansas Best was not compelled to make purchases of NBC stock after 1972 nor could it have been motivated by the prospect of obtaining a profitable return on its purchases. The conglomerate carried through on a losing proposition solely to preserve its business reputation and therefore we hold that it is entitled to an ordinary loss on the disposition of NBC shares acquired in the years 1973 through 1976.

It must be observed that a small percentage of shares was acquired during this period by purchase. One purchase was motivated by business purposes and is also entitled to ordinary loss treatment. The purchase was made from the outgoing president of NBC in order to secure his resignation as chief executive officer of NBC and to secure his promise that he would cease disrupting negotiations for the sale of NBC.

The second purchase was from Universal Insurance Company. Petitioner asserts that this purchase was made to protect its subsidiary from regulatory sanctions because "as NBC had ceased paying dividends in 1974, NBC stock no longer constituted an admitted asset in determining the adequacy of Universal's capital and surplus for insurance regulatory purposes." The parties had stipulated, however, that this purchase was made from Universal Insurance Company, "a corporation *subsequently* acquired by ABC [Arkansas Best] as a consolidated subsidiary" (emphasis added). Protection of a subsidiary cannot have been the purpose of this purchase if the insurance company was not a subsidiary at the time of the purchase. Accordingly, these NBC shares must be treated as capital assets along with the initially acquired shares.

Finally, the conversion of the debentures by Arkansas Best in 1974 did not reflect optimistic investment purpose, as respondent contends, but rather an effort to further ease pressures on the bank by removing the burden of making fixed interest payments. The loss on the shares so acquired are entitled to ordinary loss treatment.

In order for the loss to be properly apportioned between its capital and ordinary components as determined above, we must address the second issue raised by petitioner. The loss should be apportioned according to the respective amounts of basis for each of the two sets of stock acquisitions. The amount realized on the disposition of all the shares of NBC stock is undisputed. The basis for the shares acquired in 1973 and subsequent years is likewise undisputed.

The parties disagree, however, whether the basis of the shares initially acquired in 1968 should include the value of 150,000 shares of Arkansas Best preferred stock (stipulated to be $1,500,000) tendered by Arkansas Best in the 1968 transaction. This basis dispute must be resolved in order to determine what portion of the total amount realized should be allocated to the respective capital and ordinary bases. Petitioner argues that the 1968 transaction was a purchase and that the value of the 150,000 shares of Arkansas Best's preferred stock was part of Arkansas Best's cost. Respondent argues that petitioner should be equitably estopped from characterizing the 1968 transaction as anything other than a tax-free reorganization, as petitioner had represented the transaction in 1968. In the alternative, respondent argues that the 1968 transaction was indeed a tax-free reorganization under section 368(a)(1)(C).

Arkansas Best concedes that it intended the 1968 transaction with Young, Inc. to be a tax-free reorganization, and that it represented the transaction as such on its Federal income tax return and to respondent. For the purposes of this case, however, Arkansas Best now urges that the transaction should not have been treated as a tax-free reorganization because the assumption of liabilities in the transaction was excessive and the requisite continuity-of-interest was thereby not preserved. Petitioner cites the following passage from section 1.368-2(d), Income Tax Regs.:

> (1) * * * In determining whether the exchange meets the requirements of 'solely for voting stock', the assumption by the acquiring corporation of liabilities of the transferor corporation,

or the fact that property acquired from the transferor corporation is subject to a liability, shall be disregarded. *Though such an assumption does not prevent an exchange from being solely for voting stock for the purposes of the definition of a reorganization contained in Section 368(a)(1)(C), it may in some cases, however, so alter the character of the transaction as to place the transaction outside the purposes and assumptions of the reorganization provisions. Section 368(a)(1)(C) does not prevent consideration of the effect of an assumption of liabilities on the general character of the transaction* but merely provides that the requirement that the exchange be solely for voting stock is satisfied if the only additional consideration is an assumption of liabilities. [Emphasis added.]

We find it unnecessary to address the merits of this issue raised by petitioner because we hold that petitioner is equitably estopped from asserting that the 1968 transaction with Young, Inc. was other than a tax-free reorganization.

Section 1.1016-6(b), Income Tax Regs., provides that "[i]n determining basis, * * * the principles of estoppel apply, as elsewhere under the Code, and prior internal revenue laws." The doctrine of equitable estoppel is, however, to be sparingly applied in Tax Court litigation and only in special circumstances. Cf. section 1311 et seq.

The traditional elements of estoppel required at common law are as follows.

(1) Conduct amounting to a misrepresentation or concealment of a material fact; (2) actual or imputed knowledge of the misrepresentation by the party to be estopped; (3) absence of knowledge of facts by the party in whose favor estoppel is applied; (4) intention or expectation of the party to be estopped that the representation or concealment will be acted upon by the other party; (5) reliance by the party seeking the estoppel; and (6) detriment to the party seeking the estoppel resulting from his reliance. See 10 J. Mertens, Law of Federal Income Taxation, sec. 60.02 (1976).

Sangers Home for Chronic Patients, Inc. v. Commissioner, 72 T.C. 105, 115 (1979). We find it unnecessary, however, to consider whether each of the above elements of estoppel are present in the instant case because based on the related doctrine of "duty of consistency" we hold petitioner is barred from asserting that the 1968 transaction with Young, Inc., was not a tax-free reorganization.

The duty of consistency, which is sometimes referred to as quasi-estoppel, is based on the theory that the taxpayer owes the Commissioner the duty to be consistent with his tax treatment of items and will not be permitted to benefit from his own prior error or omission. *Southern Pacific Transportation Co. v. Commissioner,* 75 T.C. 497, 838-839 (1980). Although the duty of consistency is akin to estoppel and has the same effect, its application does not require the presence of all the technical elements of estoppel. *Wichita Coca Cola Bottling Co. v. United States,* 152 F.2d 6 (5th Cir. 1945); *Southern Pacific Transportation Co. v. Commissioner, supra.*

In *Bartel v. Commissioner,* 54 T.C. 25 (1970), we were asked to decide whether the duty of consistency applied to the following situation. Taxpayer in *Bartel* was the sole shareholder of a corporation which was liquidated in 1964. During the preceding 11 years, taxpayer had received disbursements from the corporation which were treated by him as loans for income tax purposes. In holding that the duty of consistency prevented taxpayer from asserting that the corporate disbursements were not loans but rather compensation or dividends (and thus requiring taxpayer to compute the portion of the gain on the liquidation attributable to the loans as cancellation of indebtedness), we found particularly relevant the Fifth Circuit Court of Appeals' statement regarding the duty of consistency in *Orange Securities Corp. v. Commissioner,* 131 F.2d 662, 663 (5th Cir. 1942), affg. 45 B.T.A. 24 (1941):

> While it is true that income taxes are intended to be settled and paid annually each year standing to itself, and that omissions, mistakes and frauds are generally to be rectified as of the year

> they occurred, this and other courts have recognized that a taxpayer may not, after taking a position in one year to his advantage and after correction for that year is barred, shift to a contrary position touching the same fact or transaction. When such a fact or transaction is projected in its tax consequences into another year there is a duty of consistency on both the taxpayer and the Commissioner with regard to it, whether or not there be present all the technical elements of an estoppel. • • •*Bartel v. Commissioner, supra* at 29.

In the instant case, we believe the duty of consistency is equally applicable. Petitioner intended and represented that its acquisition of approximately 65 percent of the stock of NBC in 1968 to be a tax-free reorganization under section 368(a)(1)(C). Now, over 15 years later and well beyond the passing of the statute of limitations for that taxable year, petitioner asks us to find that the transaction was not a tax-free reorganization but in fact a purchase. As we stated in *Bartel*, "not only the equities but the practical administration of the law argue against • • • petitioner's request, ' • • •." 54 T.C. at 32. See also *Mayfair Minerals, Inc. v. Commissioner*, 56 T.C. 82, 86 (1971), affd. per curiam 456 F.2d 622 (5th Cir. 1972). Accordingly, we hold the duty of consistency requires Arkansas Best to treat its initial acquisition of NBC as a tax-free reorganization.[8]

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[8] Estoppel and its various counterparts, such as quasi-estoppel, are affirmative defenses which must be pleaded and proved. *Southern Pacific Transportation Co. v. Commissioner*, 75 T.C. 497, 838 (1980); Rule 39. Although respondent failed to formally plead estoppel, his intention to raise the issue was set forth in his trial memorandum filed with the Court and made a part of the record prior to trial. Petitioner was thus given adequate notice that respondent intended to argue the estoppel issue and consequently suffered no detriment due to respondent's failure to formally plead estoppel. Furthermore, petitioner does not argue on opening or reply brief that respondent is barred from asserting the estoppel issue on the ground that it was not formally pleaded.

The third and final issue in this case is whether petitioner is entitled to a bad debt deduction for the partial charge-off of the note acquired in the sale of the bulk of the NBC stock. On June 30, 1975, Arkansas Best sold 51 percent of NBC'c outstanding stock to a group of 63 Texas investors, herein referred to as the "Brooks group." In exchange, Arkansas Best received cash and a note with a face amount of $6,006,176 secured by the 51 percent interest in NBC (the "Note"). On January 21, 1976, Arkansas Best wrote down the value of the Note by $4,485,876 and later took a partially worthless bad debt deduction for the 1975 taxable year, which respondent disallowed.

The deductibility of partially worthless debts is governed by section 166(a)(2), which provides as follows: "When satisfied that a debt is recoverable only in part, the Secretary may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction." The language of the statute is permissive rather than mandatory, and whether a debt is partially deductible is a decision committed to the sound discretion of the Commissioner. *Brimberry v. Commissioner*, 588 F.2d 975, 977 (5th Cir. 1979), affg. a Memorandum Opinion of this Court.

A debt may be charged off as partially worthless within a taxable year only if the taxpayer shows with reasonable certainty that a specific, ascertainable portion of the debt was no longer collectible. *Sika Chemical Corp. v. Commissioner*, 64 T.C. 856, 863 (1975). In evaluating a taxpayer's claim of partial worthlessness, the Commissioner must consider all the circumstances, including the value of the collateral securing the debt and the financial condition of the debtor. *Brimberry v. Commissioner, supra* at 977; Sec. 1.166-2(a), Income Tax Regs. The same regulation also provides that the Commissioner's determination will not be disturbed unless it is plainly arbitrary or unreasonable, indicating an abuse of discretion.

Petitioner offers two points in support of the partial worthlessness of the Note in 1975: (1) Arkansas Best had received indications that the Brooks group anticipated difficulties in meet-

ing the capital demands of NBC and (2) the value of the NBC stock securing the Note had declined in value over the six months since the acquisition of the Note.

We find nothing unreasonable or arbitrary in respondent's disallowance of the claimed deduction for partial worthlessness of the Note. The facts relied upon by petitioner are insufficient to amount to a "reasonable certainty" that a portion of the Note was no longer collectible given the circumstances existing in 1975. In late January, 1976, petitioner, as directed by its independent auditors, adjusted the carrying value of the $6 million Note and petitioner's remaining investment in the stock of NBC to a level that would reflect the underlying book value of NBC as determined by audit. Petitioner made the charge off due to pressure from its independent auditors who were concerned not about tax accounting but rather the integrity of petitioner's financial statements.

We do not deem it appropriate to equate the amount of the charge off for partial worthlessness of the Note to the difference between the face amount of the Note and the book value of the NBC stock securing the Note as collateral. Book value, which under the circumstances was perhaps the most expedient method of valuing the stock for financial statement purposes, is by no means to be deemed the equivalent of actual fair market value for tax purposes. Furthermore, since with all its difficulties NBC was by no means insolvent as of the date of the write-down of the Note for financial reporting purposes, so that the value of the NBC stock would have continued to fluctuate up and down from day to day, the fair market value of the stock on the day of the financial report write-down may well have been the next day's irrelevancy. Consequently, petitioner has not convinced us that it has shown with reasonable certainty that a specific, ascertainable portion of the debt was no longer collectible at the time of the charge off. See *Thompson v. Commissioner*, T.C. Memo. 1983-81, and cases cited therein.

Respondent argues in the alternative that since petitioner was negotiating the sale of the Note at the time its value was written down, any loss realized was from the sale of a capital asset rather than from a partial bad debt. Since we have held that no deduction is allowable for partial worthlessness we need not address respondent's alternative argument.

Decision will be
entered under Rule 155.